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June 25, 2018

Ann E. Misback
Secretary
Attn: Docket No. R-1603
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

**Re: Proposed Amendments to the Regulatory Capital, Capital Plan and Stress Test Rules
(Docket No. R-1603; RIN 7100-AF2)**

Ladies and Gentlemen,

Wells Fargo & Company (Wells Fargo) is a diversified, community-based, financial services company with approximately \$1.9 trillion in assets providing banking, investments, mortgage, consumer and commercial financial services. We appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System (the Board) notice of proposed rulemaking: Amendments to the Regulatory Capital, Capital Plan, and Stress Test Rules (the Proposal).

We support the Board's objectives of improving the transparency and efficiency of the regulatory capital framework and stress testing process through the introduction of the stress capital buffer (SCB) concept; specifically, the integration of the Comprehensive Capital Analysis and Review (CCAR) with point-in-time Basel III regulatory capital requirements. We believe successful integration will result in a more coherent regulatory capital framework that provides greater clarity to investors regarding a bank's capital requirements and greater simplicity for banks and supervisors, while leveraging the integrity and key principles gained through nearly ten years of stress testing experience. We appreciate the enhancements key principles of CCAR have brought to both bank capital management and supervisory oversight. To further enhance the integrity of the stress testing process under this Proposal, we also fully support the Board's willingness to propose amendments to certain balance sheet assumptions and required capital distribution assumptions. The proposed amendments to the assumed capital distributions will not only reflect more realistic expectations of bank behavior under stress, but will more closely align with restrictions that apply under existing regulatory capital rules (and for Wells Fargo would more closely align with our own internal policy requirements).

The introduction of the SCB and its integration into the point-in-time capital requirements represents a significant shift in the regulatory capital framework. This shift magnifies the need for enhanced transparency and stability in both scenario design and the Board's modeling of stress testing results. Bringing additional transparency to the results is necessary in order to achieve the Board's stated policy objectives and to provide banks with accurate information to make capital management and credit decisions. We believe greater transparency will lead to a more robust stress testing process allowing the public to better understand the rigorous nature of the test while also allowing the Board to retain all the necessary regulatory and supervisory tools to achieve its safety and soundness objectives.

In addition to increased transparency, the introduction of the SCB necessitates reconsideration of certain aspects of the existing framework that were not modified by the Proposal (e.g. calibration of the G-SIB surcharge), as well as foreshadowing of impending changes (e.g. U.S. integration of the BCBS's final Basel III reforms) that have not yet been addressed by the Board. Due to the critical nature of these items and their interaction with the calculation of the SCB as well as our continued desire for a cohesive regulatory capital framework, our feedback provided herein focuses on the SCB Proposal directly with consideration for these other important components to bring together a final comprehensive capital framework.

There are nine key areas on which we would like to provide feedback as we evaluate the comprehensive capital management framework taking shape.

1. **Minimize volatility in capital requirements:** The Proposal has the potential to increase volatility in capital requirements, through changing CCAR scenario assumptions and modelling approaches. In order to limit this volatility, we recommend the Board consider applying guardrails through the use of range-based approaches to key asset valuation and interest rate variables similar to the well-defined unemployment rate and house price approaches, rounding out the strengthened scenario design to each of the three sets of key variables identified in the Stress Test Scenario Design Policy Statement¹. We believe it is appropriate to anchor the range of variables to historical observations, including the paths and relationships between key variables (i.e. interest rates and unemployment rates, negative correlation between rates and credit spreads, etc.). These ranges could correspond to a set of historical recession scenarios. To improve the transparency of scenario design, these ranges, and subsequent material changes to the ranges, could be provided for public notice and comment. The Board could calibrate the approaches for the additional variables at a level that is not more severe than the 2007-2009 financial crisis and behave in a manner that is consistent with historical experience for other key macroeconomic variables.

We also believe volatility could be reduced if the Board would consider limiting the use of “salient risks” to no more than one per stress test cycle. In addition, more transparently previewing to the markets the salient risks the Board is monitoring and contemplating including in the stress test would not only support this objective but would increase the integrity of the stress capital buffer by offering clarity between unique risk considerations in supervision and capital.

2. **Delay the effective date of each year's SCB to support thorough capital planning and orderly capital increases:** While we fully appreciate the nature of the SCB framework is to leverage a risk based approach that can change results year-over-year, the potential volatility in capital requirements that could result from the framework could be further mitigated by providing a bank with sufficient time to adjust to an unexpected increase in its SCB in an orderly manner. We believe this could be achieved by making the effective date of each year's SCB no sooner than April 1 as opposed to the proposed October 1 effective date. We believe it would also be

¹ 12 C.F.R. Part 252, Appendix A; Board of Governors of the Federal Reserve System, Policy Statement on Scenario Design Framework for Stress Testing, 82 Fed. Reg. 59533 (Dec. 15, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-12-15/pdf/2017-26858.pdf>.

reasonable to extend the effective date for up to one year and to apply decreases immediately, consistent with the current approach to implementing increases to the other components of the capital conservation buffer. Extending the timeline will help reduce the potential market disruption associated with concentrating possible capital actions on the three month period between June 30 and October 1 of each year and would also facilitate a more robust reconsideration process. As proposed, we do not believe the process for banks to recommend reconsideration of the SCB is useful due in part to the one quarter timeline between the notification of the new SCB and its effective date. Due to the compressed timeline, we would need to prepare for a final SCB that is unchanged from the original, which greatly diminishes the value of the reconsideration process. We believe our recommendations would result in more transparent and stable capital requirements that would facilitate effective capital management and an orderly response to SCB changes from banks and the capital markets, which is consistent with the Board's proposed expectations of senior management and our board of directors², while maintaining the robustness of the stress testing process.

3. **Enhance transparency and expand disclosure of stress modeling and assumptions:** We recommend the Board publish additional disclosures in connection with each annual CCAR cycle including: (i) model design and key input variables for key models in advance of the CCAR cycle and (ii) summary data tables with stress results by asset class, components of pre-provision net revenue (PPNR) and deductions after each CCAR cycle. The scope of models disclosed should be expanded to include the models covering net interest income, noninterest income and expense, operational risk losses, accumulated other comprehensive income (AOCI), gains and losses on trading and private equity positions, income tax expense and regulatory capital deductions. For this expanded scope of models subject to disclosure, the Board should consider enhancing transparency by providing sufficient detail to enable banks and investors to fully evaluate the models to better understand the range of results they produce. In conjunction with communicating the results of the annual stress test, the Board could provide public disclosure of model results, including detailed disclosure of loss rates at the asset class or sub-asset class level. We also fully support the extensive industry recommendations provided in the comment letter process for the earlier set of stress test transparency proposals³. However, the results of the Board models that are specific to a particular bank should be provided to the bank directly in order to ensure proprietary information is not provided to the general public. We do not believe providing this type of detail limits the robustness of the stress testing process because the results are provided after the CCAR cycle and the Board retains the ability to apply overlays, when justified based upon bank specific circumstances as part of the ongoing supervisory framework during the year.

Beyond increased transparency around the Board's modelling, the introduction of the SCB warrants establishing a formal notice and comment process for the Board to receive public input into the design of the stress scenarios. This could be achieved using a mix of qualitative and

² See Large Financial Institution Rating System; Regulations K and LL, 82 Fed. Reg. 39,049, 39,050–51 (Aug. 7, 2017). <https://www.federalregister.gov/documents/2017/08/17/2017-16736/large-financial-institution-rating-system-regulations-k-and-ll>

³ See, e.g. The Clearing House letter available at: <https://www.theclearinghouse.org/advocacy/articles/2018/01//media/088c1e28e83c4515abef5ff5f46708a8.ashx>.

quantitative disclosure regarding the upcoming scenario, so long as the disclosure is sufficiently detailed to allow for comments on the year-over-year volatility in the scenario, overall severity and coherence of the scenario including both the macroeconomic variables and global market shock (GMS). We believe this level of detail is needed to ensure robust and thoughtful feedback can be provided to make the process substantive and is achievable through the use of a traditional notice and comment process beginning in third quarter of each year with a 30-day comment period followed by the release of the final scenarios shortly after year-end. It would be preferable to receive the scenarios earlier than the current timeline and it is essential that the Board not introduce a comment process that results in receipt of the scenarios later than current practice.

4. **The Board should eliminate the pass/fail nature of the stress test process and instead more fully leverage use of ongoing supervision and compliance in its assessment of capital planning and adequacy:** Consistent with the Board's intention to integrate the point in time and stress capital requirements, we believe the current annual assessment of capital planning (both the quantitative and qualitative) would be better suited for the ongoing supervisory process including traditional remedies (i.e. issuance of MRAs, MRIAs, enforcement actions and other remedies) as opposed to an annual test with binary results. The Board has already acknowledged the benefits of this approach in eliminating the qualitative objection from the capital rule for large and non-complex firms⁴. We believe the benefits of the change in approach apply equally to the banks still subject to qualitative objection. The shift to an on-going supervisory process would increase the effectiveness and efficiency of bank-supervisor interactions while avoiding the unnecessary creation of market events that in some cases could cause avoidable adverse impacts. We believe this approach would be superior to the annual; heavily time constrained and market event driving qualitative assessment that occurs in CCAR today. In addition, we believe the assessment of the quality of capital planning has been tied too closely to areas of concern inside a bank that are loosely related to stress testing without sufficient consideration of how the capital planning framework itself is already independently identifying, monitoring and mitigating for such non-capital weaknesses. For example, a bank with an operational risk deficiency may still have a capital planning process that carries a strong or effective rating if its process and plan reflect identification and awareness of the risk, the bank provides transparency to management and its Board of Directors about the weakness and it addresses mitigating actions or controls tied to its capital assessment. We recommend the Board consider placing greater reliance on implementation of the recently proposed large financial institution rating proposal⁵ rather than a separate qualitative assessment annually as part of CCAR. The LFI Proposal includes the Board's assessment of the bank's capital planning and management in its rating which could naturally facilitate the shift from the current qualitative assessment to ongoing supervision.

With respect to the quantitative test, while we understand the Board's view that the hard quantitative failure measured against a stress test minimum would be eliminated, we believe the current proposal still leaves a quantitative failure in the CCAR construct. The Proposal effectively shifts the nature of the quantitative test from a stress minimum versus a regulatory minimum to a stress minimum versus a baseline CCAR projection. In order to truly eliminate the

⁴ See 81 FR 9308 (February 3, 2017)

⁵ Id.

quantitative failure, a new SCB could be calculated each year and in turn banks could be required to meet their respective minimum capital requirements, inclusive of the SCB, beginning on April 1 of the subsequent year. To the extent the bank's baseline capital plan does not meet the minimum capital requirement inclusive of the SCB, which would only occur due to an unexpected increase in the SCB, there is no need for the Board to object to the banks' plan. The bank will simply be required to take the necessary actions to adjust its planned capital actions and risk profile to ensure ongoing compliance or become subject to the payout restriction framework that is already part of the point in time capital requirements. We are not advocating that a plan is not needed, as we believe that the submission of an annual capital plan inclusive of the key principles of risk identification, estimation, capital impact assessment, governance and internal controls is not only a critical tool for supervision but critical for bank capital management. The annual capital plan should be complemented by quarterly capital adequacy updates that incorporate forward looking baseline projections aligned with risk assessments. These core elements are already set out in SR15-18 and we believe are important to the foundation of a robust capital management framework. With this in mind, there should no longer be a need to bind a bank to its baseline capital distributions annually other than to restrict adjustment to the common dividends included in the calculation of the SCB. As actual results are realized a bank should be expected to adjust its baseline capital plan with either increases or decreases from the plan in a dynamic manner in order to ensure ongoing compliance with its minimum capital requirements. This aspect of routine capital adequacy assessment using forward-looking projections would fit naturally with the desire of the Board to better leverage the ongoing supervisory tools throughout the year as quarterly capital outlooks would be provided to supervisors through bank Board reporting. This approach would have the additional benefit of reducing complexity as the requirement for a resubmission (aka 'mulligan') within two days of receipt of a new SCB would no longer be necessary. We believe these changes will improve the effectiveness and efficiency of our capital planning process and supervision while also reducing complexity and increasing alignment between bank capital management frameworks and the framework to supervise bank capital.

5. **Existing capital distribution restrictions need to be recalibrated if SCB is incorporated into point in time capital requirements:** We believe the Board needs to re-evaluate existing payout restriction rules in light of introduction of the SCB. The Proposal states the Board intended to "eliminate the need for firms to manage to these two different assessments of capital adequacy and would address inconsistencies in assumptions regarding capital distributions in the two regimes." We support this simplification objective and have recommendations to ensure the final rule achieves the Board's objective. We also believe the integration of the point in time and stress requirements will change the dynamics of the payout restriction framework whereby a bank can become subject to payout restriction not only for a performance related decline in its earnings power and capital ratios, but also due to an increase in its SCB. Marrying the forward-looking CCAR process, including the SCB, with the backward looking calculation of eligible retained income can produce severe unintended consequences for a healthy bank's planned capital actions under certain economic conditions, such as now, when bank payout ratios are near 100% of earnings. Under the Proposal, an otherwise healthy bank experiencing an unexpected increase in its SCB that in turn results in its capital ratio falling below its minimum capital requirements by

even a single basis point will be forced to stop all capital distributions, including prefunded common and preferred dividends, until its capital position is again above the minimum requirements. Such a result could in turn cause pro-cyclical responses from a bank's counterparties and investors. We believe our recommendations would more fully align the point-in-time and stress capital payout restrictions and result in greater consistency between the calculation of the SCB and payout restriction framework, while retaining the supervisory safety and soundness objectives.

First, we recommend the Board align treatment of both the four quarters of common dividends and the full nine quarters of preferred dividends. The proposed definition of eligible retained income⁶ does not achieve this alignment. Instead, the Proposal would restrict capital distributions for breach of the proposed SCB even though the proposed SCB calculation itself effectively prefunds these distributions⁷. The Board could address this inconsistency by eliminating the prefunded dividends (both common and preferred) from the minimum capital requirement applicable to the payout restriction thresholds.

Alternatively, the Board could adjust the definition of eligible retained income to use a gross approach as opposed to the current net approach. Under a gross approach, eligible retained income would not be reduced for historical distributions and would better reflect a bank's future earnings power. To the extent a bank has strong historical earnings; a breach of the payout restriction would likely be the result of an unexpected increase in the SCB and the gross approach would permit some reduced amount of capital distributions while also facilitating a rebuild of capital to achieve a minimum capital requirement inclusive of the SCB. To the extent a bank breaches the payout restriction threshold due to a decline in its capital position; the gross calculation of historical earnings would curtail distributions naturally because those gross historical earnings would reflect the weak earnings performance. Consequently, we believe the Board can address both the internal inconsistency between the calculation of the SCB and payout restriction framework as well as re-align the function of the payout restriction framework in a manner consistent with effective capital management by modifying the definition of eligible retained income.

6. **Introduction of the SCB emphasizes the need to reconsider G-SIB calibration:** Consistent with the views of former Governor Tarullo and former Chair Yellen⁸ expressed during the conceptual development of the Proposal, we agree that the effect of the SCB is to combine the G-SIB surcharge and stress losses. This effect is amplified by requiring the use of the Method 2 G-

⁷ Though not a separate add-on component of the SCB, the calculation of peak-to-trough losses in the SCB assumes preferred dividends are paid throughout the entire forecast period.

⁸ Former Chair Yellen Testimony before the Committee on Financial Services, U.S. House of Representatives on September 28, 2016 - "For the eight U.S. G-SIBs, the move to the stress loss buffer--which would be similar in effect to including the G-SIB capital surcharge in the CCAR post-stress minimum--would result in a significant aggregate increase in capital requirements."

Former Governor Tarullo speech at the Yale University School of Management Leaders Forum, September 26, 2016 - "Because the GSIB capital surcharge already exists as an additional buffer requirement in the regulatory capital rules, the stress capital buffer approach would effectively add the GSIB capital surcharge to our estimates of the amount of capital needed under stress."

SIB surcharge, which is invariably greater than the Method 1 surcharge. The Board should revisit whether this new combination of stress losses and G-SIB surcharge results in double counting of capital charges, particularly for capital markets activities, which are a primary driver of the G-SIB surcharge and are also subjected to significant losses in CCAR through the Global Market Shock (GMS) and Counterparty Default Scenario. In the immediate term and in conjunction with finalizing the Proposal, we recommend the use of Method 1 instead of Method 2 to avoid continuation of the historical practice of super-equivalency to the BCBS. We also believe there are methodological flaws and potential double counting embedded in both methods and recalibration is warranted. Specifically, the Method 1 approach should be amended to address the unwarranted impact of foreign exchange rate volatility on G-SIB scores. G-SIBs have made considerable progress in improving resolvability through the implementation of a broad swath of post-crisis reforms and specifically the evolution of the living will process and advent of Total Loss Absorbing Capacity (TLAC) requirements. These improvements alone should materially reduce the expected G-SIB loss given default and therefore impact the G-SIB calibration. We recommend the Board pursue recalibration of Method 1 via the BCBS and begin the process of recalibrating its own Method 2 in the immediate term consistent with its own final rule⁹ to update the fixed coefficients to reflect economic growth.

7. **Countercyclical tools should be used in a coherent manner:** Similar to the impact of introduction of the SCB on the G-SIB surcharge, the SCB construct adds stress losses to any Countercyclical Capital Buffer (CCyB). The inclusion of SCB in the point in time capital requirements closely aligns with the CCyB's original purpose of incorporating countercyclical capital requirements, as mandated in Dodd-Frank, while also ensuring that banking organizations are resilient to unexpected losses by not just normal fluctuations in economic and financial conditions, but also through stressed conditions with the expressed ability to remain active in the provision of credit. Because the stress test scenario design framework explicitly includes countercyclical elements, specifically the unemployment rate and housing price index variables¹⁰, imposition of a non-zero CCyB would represent a double counting of capital and insert unnecessary complexity. In order to ensure coherence in the use of countercyclical tools, we believe the Board should propose any increase from a zero CCyB concurrent with a notice and comment process on the stress test scenario and indicate how a non-zero CCyB should be reflected in a bank's baseline capital forecast. Lastly, we recommend the Board update its final policy statement on the CCyB¹¹ to reflect how the countercyclical scenario design features of stress testing impact the empirical models and quantitative indicators to evidence that 'systemic vulnerabilities are meaningfully above normal to justify imposition of the CCyB.

⁹ Final G-SIB surcharge rule states, "The Board will periodically reevaluate the framework to ensure that factors unrelated to systemic risk *do not have an unintended effect on a bank holding company's systemic indicator scores.*"

¹⁰ Proposed Stress Test Scenario Design Policy Statement states, "*Beginning in 2016, the countercyclical element of the Board's scenario design framework acted to increase scenario severity, so while the peak level of the unemployment rate remained about the same, the change in the unemployment rate increased. The countercyclical design of the scenarios is also reflected in the change in real GDP, which, in 2017, declined by the largest amount since 2012. The Board also evaluated its approach to developing the path of house prices, which is a key scenario variable, to assess whether it could improve the transparency of the measure and to identify a guide that would formalize the Board's countercyclical objectives.*"

¹¹ See 12 CFR Part 217, Appendix A The Federal Reserve Board's Framework for Implementing the U.S. Basel III Countercyclical Capital Buffer

8. **Further simplify the use of risk sensitive capital measures:** The Board should consider the long-term need for the current Advanced Approaches given introduction of SCB as the risk adjusted component of the broader framework (i.e. elimination could provide further simplification without reducing quality of the robustness of the regulatory framework). Consistent with that view, we support the Board's exclusion of the SCB from the minimum capital requirements under the Advanced Approaches and continued exclusion of the Advanced Approaches from CCAR. Retaining the Advanced Approaches with the 2.5% Capital Conservation Buffer (CCB) would not meet the stated goal of reducing complexity because this aspect of the point in time capital framework would not be integrated with stress testing, including a separate set of payout restrictions. Managing capital using both the Advanced Approach ratio with a static 2.5% CCB and the Standardized Approach ratio with a dynamic SCB would be very complex as a banks binding capital ratio would likely change at various points in the economic cycle.

We believe the Advanced Approaches could be eliminated and the current Standardized Approach replaced with the Standardized Approach in the recently finalized Basel III package of reforms alongside the SCB component to bring a comprehensive approach into one regime. The final Basel III package simultaneously increases the risk sensitivity of its Standardized Approach while decreasing the risk sensitivity of its Advanced Approach. The more risk sensitive Basel Standardized Approach coupled with the SCB has the potential to result in a single standardized approach that is appropriately calibrated and sufficiently risk-sensitive measure that would further reduce complexity by reducing the required number of ratios from fourteen to nine¹², would improve simplicity by more fully aligning and integrating the point-in-time and stress capital requirements, and would continue to support strong risk management. This approach would enhance supervision through streamlining measures without sacrificing regulatory tools to supervise risk. We emphasize that the U.S. integration of Basel III should be calibrated in a manner that does not incrementally increase either point-in-time or stress capital requirements; however, we believe this objective is achievable based upon latitude provided for national discretion in the final Basel agreement. We look forward to engaging with the Federal Reserve and other banking agencies to integrate the final Basel III package of reforms into the U.S. regulatory capital framework in an efficient and cohesive way.

9. **In principle, the change in credit impairment accounting (CECL)¹³ should not materially impact stress test results:** We recommend the Board carefully assess its approach to implementing CECL with specific attention to the impact on peak-to-trough losses and thus the SCB. The interaction of CECL and the SCB goes beyond the impact of adoption of CECL on retained earnings to focus on the timing of loss recognition and overall quantum of losses expected through the nine quarter stress testing horizon. While the change to accounting

¹² The five Advanced Approaches ratios that could be eliminated are: Common Equity 1, Tier 1 and Total Capital, External TLAC and External Long-Term Debt.

¹³ Accounting Standards Update (ASU or Update) 2016-13 – Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

standards must be reflected as the basis for our stress results, we do not believe a change in accounting methods for measuring credit impairment should impact the expected losses observed under stress. While the change in accounting may impact the timing of loss recognition, the total amount of loss content should not materially increase. It will be critical for the Board to adopt an approach to stress testing under CECL that not only simulates how a stress event would likely unfold over the nine quarter horizon, but is also conceptually consistent with U.S. GAAP without being overly complex. Again, transparency will be critical because the SCB will be dependent on the Board's modelling of CECL. If CECL implementation is material to stress test results, it provides evidence that CECL has fundamentally changed the nature of the allowance for loan loss and the interaction between the accounting and capital frameworks, which in turn would justify recalibration of the regulatory capital minimum requirements. We appreciate the Board's efforts to-date to engage the industry on this topic and look forward to additional discussions, particularly as the remaining interpretive and operational issues associated with the adoption of CECL are clarified and the impact of CECL is better understood by the industry and regulators.

Conclusion

We are encouraged by the Board's proposals and willingness to seek input as a comprehensive capital management framework truly begins to take shape using the best of the various components. We appreciate the important role and needs of the Board to fulfill your responsibilities and appreciate the opportunity to work with you. We look forward to engaging with the Board staff on both refinements to the existing framework and integration of further reforms in a cohesive and efficient manner.

Thank you for considering our comments. If you have any questions, please feel free to contact me directly or you may also contact Jeff Colson, Head of Capital Management.

Sincerely,

A handwritten signature in dark ink, appearing to read "Neal Blinde", written in a cursive style.

Neal Blinde
Executive Vice President and Treasurer